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OFRs: help or hindrance?

Under new detailed proposals from the DTI, all UK quoted companies will have to produce a new statutory Operating and Financial Review (OFR) for financial years beginning on or after 1 January 2005. The Quoted Company Alliance (QCA) working group on the OFR has submitted its comments by the consultation deadline but we must now wait until November to know whether we have been able to effect any change.

What are the OFR proposals?

The DTI's detailed proposals for a new statutory OFR were published in May. The key features are that:

- directors of quoted companies will be required to give a "balanced and comprehensive analysis" of their business, in the form of a narrative report, as part of the company's annual reports and accounts to shareholders
- this will include the company's objectives, strategies and key drivers of the business
- the focus will be on forward-looking and qualitative information (not traditionally included in annual reports)
- directors will need to consider whether to include a range of issues relevant to the business such as information about employees, environmental matters and community and social issues
- the OFR is to be reviewed by the company's auditors
- the auditors will be required to give an opinion on whether the directors have prepared the OFR after "due and careful enquiry", and
- compliance will be enforced through a regime similar to that for financial statements (ie criminal offences and penalties and administrative enforcement through the Financial Reporting Review Panel).

The DTI has issued guidance to help directors prepare OFRs and plans to review how effectively the OFR is working after five years.

The Accounting Standards Board (ASB) is likely to be appointed as the body that will issue detailed standards on what should be included in the statutory OFR.

What is wrong with the OFR proposals?

The key submissions made by the QCA working group (chaired by Chris Wilkins of Wellington Holdings plc) were:

- larger companies only (ie those within the FTSE 350) should be required to produce an OFR on the grounds of cost (producing an OFR should be "best practice" for smaller companies rather than a requirement)
- auditors should not have a role in producing the OFR (otherwise OFRs will turn into standard form documents rather than the user friendly narratives they are intended to be), and
- new criminal and other penalties are not required to ensure enforcement as there is sufficient infrastructure in existing legislation.

Does this affect AIM and OFEX companies?

Under the current proposals, only companies whose shares are quoted on the Official List will be required to produce statutory OFRs. AIM and OFEX companies are not affected but they will be covered by a different (although similar) requirement, also to be introduced with effect from 1 January 2005.

The background is that the new statutory OFR is intended to implement both domestic proposals (the Government's White Paper 'Modernising Company Law') and EC law (the Accounts Modernisation Directive). For quoted companies, preparing an OFR in accordance with the regulations avoids having to report separately, in their directors' report, on the matters specified in the Directive.

Non-quoted companies will still have to comply with the Modernisation Directive which requires large and medium-sized companies to provide an enhanced review of the company's business (for years starting

on or after 1 January 2005). The expanded report should include a review of the development and performance of the company's business, financial and non-financial key performance indicators and environmental and employee matters.

So even though they are 'unquoted' and do not have to produce a statutory OFR, AIM and OFEX companies will (if they are "large" or "medium-sized") need to produce an expanded directors' report to satisfy the requirements of the Modernisation Directive. Medium-size companies are, however, exempted from the expanded report requirement in so far as it relates to non-financial information. A company is "medium sized" if two or more of the following apply in a year: turnover not more than £22.8m; balance sheet total not more than £11.4m; fewer than 250 employees.

The Government intends to issue a summary of responses to its proposals by 6 November, when the draft regulations are to be laid before Parliament. We will keep you updated.

In the meantime, the QCA's full submission can be found at www.qcanet.co.uk.

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